Supreme Court, U.S.
FILED
JAN 8 1999
OFFICE OF THE CLERK

No. 97-1868 (15)

IN THE
Supreme Court of the United States
OCTOBER TERM, 1998

UNUM LIFE INSURANCE COMPANY OF AMERICA,
Petitioner,

v.

JOHN E. WARD,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL LEAGUE OF CITIES, U.S. CONFERENCE OF MAYORS, AND INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION AS *AMICI CURIAE* SUPPORTING RESPONDENT

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

36pp

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QUESTIONS PRESENTED

1. Whether California's notice-prejudice rule is a state law saved from preemption by ERISA's saving clause.

2. Whether California's *Elfstrom* rule is a state law saved from preemption by ERISA's saving clause.

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INTEREST OF THE *AMICI CURIAE*

Amici are organizations whose members include state, county and municipal governments and officials throughout the United States.[1] *Amici* have a compelling interest in the extent to which the ERISA saving clause preserves the States' traditional power to regulate insurance.

For one hundred fifty years the regulation of insurance has been the responsibility of the States. Congress expressly preserved this exercise of the States' historic police powers in the McCarran-Ferguson Act and reaffirmed it thirty years later in ERISA's saving clause. Petitioner and its *amici* urge upon this Court an untenably narrow reading of ERISA's saving clause that is plainly contrary to Congress' intent and interferes with the States' authority to regulate insurance.

Because of the importance of the issues presented to the ability of the States to exercise one of the core components of their regulatory authority, *amici* submit this brief to assist the Court in the resolution of this case.

SUMMARY OF ARGUMENT

1. As this Court has long recognized, the regulation of insurance is a classic exercise of the States' historic police powers. Congress expressly authorized state regulation of insurance both in 1945, when it enacted the McCarran-Ferguson Act, and in 1974, by ERISA's saving clause.

ERISA expressly saves from preemption "any law of any State which regulates insurance." 29 U.S.C. § 1144 (b)(2)(A). In applying the saving clause, the Court uses a two-part test. The first part asks whether, as a matter of "common-sense," the law is "specifically directed toward

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[1] Pursuant to Rule 37.3 of the Rules of this Court, the parties have consented to the filing of this brief *amicus curiae*. Their letters of consent have been filed with the Clerk of the Court.

Pursuant to Rule 37.6 of the Rules of this Court, *amici* state that this brief was not authored in whole or in part by counsel for a party, and no person or entity, other than the *amici* or their members, made a monetary contribution to the preparation or submission of this brief.

[the insurance] industry." *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 50 (1987). The Court next considers the three factors identified in *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119, 129 (1982). It does so, however, only to verify the "common-sense" conclusion that a state law regulates insurance. *See Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 743 (1985). The Court has never mandated that the three *Pireno* factors even be considered, much less each be satisfied, to save a state insurance law from preemption by ERISA.

The conclusion that rigid adherence to the three *Pireno* factors is not required in ERISA saving clause analysis is supported by the Court's treatment of the very similar saving provision in the first clause of section 2(b) of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b). In *Department of Treasury v. Fabe*, 508 U.S. 491 (1993), the Court held that cases interpreting the second clause of section 2(b) relating to the business of insurance, such as *Pireno*, do not control in cases arising under the first clause which relates to state insurance regulation. *Fabe* therefore plainly undercuts UNUM's argument that the *Pireno* factors play a larger role in applying ERISA's saving clause than they do under the first clause of section 2(b) of McCarran-Ferguson, upon which the ERISA saving clause was modeled.

2. California's notice-prejudice rule, which prohibits an insurer from denying coverage because of late notice unless the insurer can demonstrate that it will be substantially prejudiced, is saved from preemption by the ERISA saving clause. First, it fully satisfies the "common-sense" requirement that it be a law "specifically directed toward [the insurance] industry." *Pilot Life*, 481 U.S. at 50. The many state laws on this subject demonstrate that when state courts and legislatures address the legal significance of the timing of notice under insurance policies, they are regulating insurance specifically and not simply applying general contract principles.

Second, consideration of the *Pireno* factors supports the conclusion that the notice-prejudice rule "regulates insurance" under ERISA's saving clause. The notice-prejudice rule is obviously an "integral part of the policy relationship between the insurer and the insured." *Pilot Life*, 481 U.S. at 48-49 (quoting *Pireno*, 458 U.S. at 129). It is also "limited to entities in the insurance industry." *Id.*

Because a state law need not satisfy all three *Pireno* factors in order to be saved from preemption by ERISA, this Court could hold that the notice-prejudice rule is saved without regard to whether it satisfies *Pireno*'s risk-spreading factor. In any event, the court of appeals' conclusion that the notice-prejudice rule does not spread risk is incorrect. The rule does in fact spread risk by requiring the insurer to provide coverage for an occurrence that would not otherwise be covered because the claim was not made within the time limit set forth in the policy.

Finally, UNUM's argument that the notice-prejudice rule is preempted because it conflicts with ERISA is without merit. The notice-prejudice rule does not conflict with ERISA's civil enforcement scheme or with any of the statute's other provisions.

3. In *Elfstrom v. New York Life Ins. Co.*, 432 P.2d 731, 737 (Cal. 1967), the California Supreme Court announced the rule of insurance law that "the employer is the agent of the insurer in performing the duties of administering group insurance policies." *Elfstrom* rejected the traditional rule that made the employer the agent of employees covered by group insurance plans. As a matter of fairness, *Elfstrom* places upon the insurer the cost of employer mistakes in administering group insurance policies.

The *Elfstrom* rule is a state law that regulates insurance by requiring the performance of the insurance contract even when the employer makes mistakes that might otherwise excuse performance by the insurer under the terms of the policy. *Elfstrom* satisfies both the "common-sense" test for a state law that regulates insurance and each of the three *Pireno* criteria. It is also consistent with ERISA's other provisions, including its fiduciary rules. It is accordingly saved from preemption by ERISA's saving clause.

ARGUMENT

I. A STATE LAW THAT REGULATES INSURANCE CAN BE SAVED FROM PREEMPTION UNDER ERISA WITHOUT SATISFYING ALL THREE *PIRENO* FACTORS

A. ERISA's Saving Clause Reaffirms The National Policy Of Making Insurance Regulation The Responsibility Of The States

The regulation of insurance is a classic exercise of the States' historic police powers. *See, e.g., SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 68-69 (1959) ("When the States speak in the field of 'insurance,' they speak with the authority of a long tradition."); *Northwestern Nat'l Life Ins. Co. v. Riggs*, 203 U.S. 243, 254 (1906). "Since 1851 the several states, spurred by necessity and with acquiescence of every branch of the Federal Government, have been building up systems of regulation to discharge this duty toward their inhabitants." *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 584 (1944) (Jackson, J., dissenting).

Congress expressly authorized this exercise of the States' police powers when, in 1945, it enacted the McCarran-Ferguson Act. McCarran-Ferguson declares the national policy that "the continued regulation and taxation by the several States of the business of insurance is in the public interest." 15 U.S.C. § 1011. *See also id.* § 1012(b) ("No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance."). Congress took this action with

> full knowledge of the nation-wide existence of state systems of regulation and taxation; [and] of the fact that they differ greatly in the scope and character of the regulations imposed. . . . Congress could not have been unacquainted with these facts and its purpose was evidently to throw the whole weight of its power

> behind the state systems, notwithstanding these variations.

Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 430 (1946).

The national policy of committing the regulation of insurance to the States was reaffirmed in ERISA. ERISA's saving clause, 29 U.S.C. § 1144(b)(2)(A), expressly exempts from preemption "any law of any State which regulates insurance" in wording similar to that of § 2(b) of McCarran-Ferguson. *See Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 744 n.21 (1985). The Court has recognized that the ERISA saving clause, like the McCarran-Ferguson Act, necessarily results in variations in law from State to State, but that "[s]uch disuniformities . . . are the inevitable result of the congressional decision to 'save' local insurance regulation." *Id.* at 747.

B. ERISA's Saving Clause Does Not Require That All Three *Pireno* Factors Be Satisfied

In *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), this Court identified three factors that are used to determine whether a business practice is part of the business of insurance and is therefore exempt from the antitrust laws under § 2(b) of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b):

> [*F*]*irst*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry.

458 U.S. at 129; *see also Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 212-18 (1979). This Court's decisions interpreting ERISA's saving clause also consider these factors. *See Metropolitan Life*, 471 U.S. at 742-43; *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 50-51 (1987).

The starting point in analyzing the proper use of the *Pireno* factors in this case is the terms of ERISA itself.

Section 514(a) preempts state laws that "relate to" employee benefit plans. 29 U.S.C. § 1144(a). Section 514(b)(2)(A), however, ensures that "nothing in [ERISA's employee benefits rights provisions] shall be construed to exempt or relieve any person from any law of any State which regulates insurance." 29 U.S.C. § 1144(b)(2)(A). This saving clause is designed to protect traditional state regulatory powers from preemption. As this Court explained in *New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*:

> [W]e have never assumed lightly that Congress has derogated state regulation, but instead have addressed claims of pre-emption with the starting presumption that Congress does not intend to supplant state law. Indeed, in cases like this one, where federal law is said to bar state action in fields of traditional state regulation, we have worked on the "assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."

514 U.S. 645, 654-55 (1995) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)) (other citations omitted); *see also Fort Halifax Packing Co., Inc. v. Coyne*, 482 U.S. 1, 19 (1987) ("ERISA pre-emption analysis 'must be guided by respect for the separate spheres of governmental authority preserved in our federalist system.'") (quoting *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 522 (1981)).

In construing ERISA's saving clause, this Court uses a "common-sense" test: "[A] law must not just have an impact on the insurance industry, but must be specifically directed toward that industry" to qualify as a law regulating insurance. *Pilot Life*, 481 U.S. at 50; *see also id.* (concluding that "a common-sense understanding of the phrase 'regulates insurance' does not support the argument that the Mississippi law of bad faith falls under the saving clause"); *Metropolitan Life*, 471 U.S. at 740.

This Court has also consulted the *Pireno* factors in ERISA cases, but it does so only to verify the "common-sense" conclusion that a state law "regulates insurance." *Pilot Life*, 481 U.S. at 50; *see also id.* at 49 (noting that the "considerations weighed" under the *Pireno* factors "argue against the assertion that the Mississippi law of bad faith is a state law that 'regulates insurance'"); *Metropolitan Life*, 471 U.S. at 743 (characterizing the *Pireno* factors as "criteria relevant" and noting that "[a]pplication of [the *Pireno* factors] suggests that mandated-benefit laws are state regulation of the 'business of insurance'"). Although UNUM urges otherwise, this Court has never mandated that the *Pireno* factors must be considered, much less met, to save a state law under ERISA. *Cf. FMC Corp. v. Holliday*, 498 U.S. 52, 61 (1990) (state anti-subrogation provision is a state law which regulates insurance under ERISA's saving clause without any reference to the *Pireno* factors).

Mandatory application of any *Pireno* factor is also unnecessary because the common-sense approach to preemption suggests one last consideration that would not be necessary if the common-sense test were subject to the rigid analysis UNUM urges the Court to undertake. *Pilot Life* suggests an additional inquiry, beyond application of the *Pireno* factors, that courts should conduct. This inquiry asks whether the state law at issue comports with "the role of the saving clause in ERISA as a whole." *Pilot Life*, 481 U.S. at 51 (stating "we are obliged in interpreting the saving clause to consider not only the factors by which we were guided in *Metropolitan Life*, but also the role of the saving clause in ERISA as a whole"). *See id.* at 57. This safety valve—requiring preemption of state laws that otherwise may meet the "common-sense" test—would be unnecessary if all three *Pireno* factors had to be met before a state law could even qualify as a law regulating insurance.

That this Court did not intend to rigidly require the *Pireno* factors to be met to save a state law from ERISA preemption is also strongly supported by a comparison with this Court's treatment of the similar saving provision

in the McCarran-Ferguson Act.[2] This Court has specifically recognized the parallel goals of the McCarran-Ferguson Act and ERISA's saving clause:

> The ERISA saving clause, with its similarly worded protection of "any law of any State which regulates insurance," appears to have been designed to preserve the McCarran-Ferguson Act's reservation of the business of insurance to the States. The saving clause and the McCarran-Ferguson Act serve the same federal policy and utilize similar language to define what is left to the States.

Metropolitan Life, 471 U.S. at 744 n.21.

This Court's analysis under the first clause of § 2(b) of the McCarran-Ferguson Act—the clause preserving state laws "regulating the business of insurance"—is relevant here because it closely parallels ERISA's saving clause language, which preserves any state law which regulates insurance. *See id.*; 29 U.S.C. § 1144(b)(2)(A). In *Department of Treas. v. Fabe*, 508 U.S. 491, 504-06 (1993), this Court reasoned that cases implicating the second clause of § 2(b) do not control in cases arising under the first clause. Specifically, this Court made clear that analysis under the first clause of § 2(b) is not so "narrowly circumscribed" as is analysis under the second clause because "[t]o equate laws 'enacted . . . for the purpose of regulating the business of insurance' with the 'business of insurance' itself . . . would be to read words

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[2] ERISA's saving clause is modeled after § 2(b) of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b), which also saves state insurance regulation from preemption. Section 2(b) of the McCarran-Ferguson Act provides in pertinent part:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, . . . unless such Act specifically relates to the business of insurance: Provided, That . . . [the federal antitrust statutes] shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.

15 U.S.C. § 1012(b).

out of the statute. This we refuse to do." *Id.* at 504.[3] The Court further explained that "[t]he broad category of laws enacted 'for the purpose of regulating the business of insurance' . . . necessarily encompasses more than just the 'business of insurance.'" *Id.* at 505.

Accordingly, the *Fabe* Court concluded that an Ohio statute that required distribution of an insolvent insurance company's assets to policyholders in preference to other creditors, including the United States, "'regulat[es] the business of insurance' to the extent that it serves to ensure that . . . policyholders ultimately will receive payment on their claims." *Id.* at 506 (quoting 15 U.S.C. § 1012(b)). The Court therefore purposefully took a broader view of what constitutes the regulation of the "business of insurance" under the first clause of the McCarran-Ferguson Act saving provision than it did when it determined what constitutes the "business of insurance" as the term is used in the second clause of the same Act in *Royal Drug* and *Pireno*. *Fabe* therefore plainly undercuts UNUM's argument that the *Pireno* factors play a larger role in applying the ERISA saving clause than they do under the first clause of section 2(b) of the McCarran-Ferguson Act, the very statute upon which the ERISA saving clause was modeled.

This Court's analysis in *Fabe* reinforces the conclusion that the *Pireno* factors are not dispositive of the issue of whether a state law "regulates insurance" for purposes of ERISA's saving clause. Indeed, the case for a more limited role for the *Pireno* factors is even stronger in the ERISA context than under McCarran-Ferguson because ERISA uses language that is more expansive than the language used in the first clause of McCarran-Ferguson

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[3] One commentator concludes that "courts resolving questions of the scope of ERISA's saving clause should apply the broader construction of the phrase 'business of insurance' as directed by *Fabe*," rather than rigidly applying the *Pireno* factors. Karen A. Jordan, *ERISA Preemption: Integrating* Fabe *Into The Saving Clause Analysis*, 27 Rutgers L.J. 273, 311 (1996).

construed in *Fabe*.[4] Accordingly, a state law need not satisfy all three *Pireno* factors in order to be saved from preemption by ERISA.[5]

II. CALIFORNIA'S NOTICE-PREJUDICE RULE IS SAVED FROM PREEMPTION

The notice-prejudice rule precludes an insurer from denying coverage because of late notice under the terms of the policy unless the insurer can demonstrate that it will be substantially prejudiced if the notice provision is not enforced as written. *See, e.g., Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 15 Cal. Rptr. 2d 815, 845 (Ct. App. 1993). Applying this Court's common-sense test, informed by consideration of the *Pireno* factors and the underlying goals of the saving clause, this Court should hold that the notice-prejudice rule is not preempted by ERISA.

A. The Notice-Prejudice Rule Meets The Common-Sense Definition Of A Law Regulating Insurance

A "common-sense" definition of a law regulating insurance requires that "a law must not just have an impact

[4] The ERISA saving clause, by its terms, applies to "any law of any State which regulates insurance," 29 U.S.C. § 1144(b)(2)(A), while the first clause of § 2(b) of the McCarran-Ferguson Act applies to laws which have the "purpose of regulating the business of insurance." 15 U.S.C. § 1012(b).

[5] UNUM's argument for a strict application of the *Pireno* factors assumes that *Pireno* itself requires that all three factors must be met in the antitrust immunity context. *See* Pet. Br. 24-26. This assumption, however, finds no basis in any of this Court's antitrust immunity cases because the Court has only considered cases in which none of the factors was met. *See Pireno*, 458 U.S. at 130-33 (holding that none of the three factors was satisfied); *Royal Drug*, 440 U.S. at 212-17 (same).

Indeed, the language in *Pireno* suggests the opposite conclusion: this Court referred to the three factors as "*criteria relevant* in determining whether a particular practice is part of the 'business of insurance' exempted from the antitrust laws by § 2(b)." *Pireno*, 458 U.S. at 129 (emphasis added). Moreover, the Court emphasized in *Pireno* that "[n]one of these criteria is necessarily determinative in itself." *Id.* The Court's language is inconsistent with a view that the *Pireno* factors comprise a rigid test under which each element is dispositive.

on the insurance industry, but must be specifically directed toward that industry." *Pilot Life*, 481 U.S. at 50. The notice-prejudice rule fully meets this test. Indeed, a survey of state law on the enforceability of notice provisions in insurance contracts demonstrates that when state courts and legislatures consider this issue, they are regulating insurance specifically and not simply applying general contract principles in an insurance context.

Almost every State has an insurance rule or statute that dictates whether a notice-forfeiture provision in an insurance contract is enforceable without showing prejudice. California follows the majority view that an insurer must show prejudice to deny coverage because of late notice.[6] The California Supreme Court has determined that "[a]n insurer may assert defenses based upon a breach by the

[6] Alaska, Arizona, California, Delaware, Hawaii, Kansas, Kentucky, Maine, Michigan, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Washington, and West Virginia require that the insurer demonstrate prejudice in order to deny benefits because of late notice. *See* Eugene R. Anderson *et al.*, *Draconian Forfeitures of Insurance: Commonplace, Indefensible, and Unnecessary*, 65 Fordham L. Rev. 825, 862-69 (1996) (collecting cases and statutes). In addition, Maryland, Massachusetts, and Wisconsin have notice-prejudice statutes. *See* Md. Code Ann., Ins., § 19-110; Mass. Gen. L. ch. 175, § 112; Wis. Stat. § 631.81. *See also* Kathleen E. Wherthey, *Survey: Developments in Maryland Law, 1992-93*, 53 Md. L. Rev. 948, 951 & n.30 (1994); Charles M. Marvel, Annotation, *Modern Status of Rules Requiring Liability Insurer to Show Prejudice to Escape Liability Because of Insured's Failure or Delay in Giving Notice of Accident or Claim, or in Forwarding Suit Papers*, 32 A.L.R. 4th 141 (1981); Barry R. Ostrager & Thomas R. Newman, *Handbook on Insurance Coverage Disputes* § 4.02[c][2], at 109-10 (8th ed. 1995) (collecting cases adhering to the "emerging majority view" that late notice does not relieve the insurer of its obligations unless the delay prejudices the insurer); Robert E. Keeton & Alan I. Widiss, *Insurance Law: A Guide to Fundamental Principles, Legal Doctrines, and Commercial Practices* § 7.2, at 763 (1988) (noting that "there is something approaching a consensus in regard to the general proposition that an insured's coverage should only be lost when the insurer has been prejudiced").

insured of a condition of the policy . . . but the breach cannot be a valid defense unless the insurer was substantially prejudiced thereby." *Campbell v. Allstate Ins. Co.*, 384 P.2d 155, 156 (Cal. 1963) (collecting cases). "In order to demonstrate actual, substantial prejudice from lack of timely notice, an insurer must show it lost something that would have changed the handling of the underlying claim." *Shell Oil*, 15 Cal. Rptr. 2d at 846. California's notice-prejudice rule, which predated ERISA by nine years, is grounded in public policy concerns for the protection of policyholders against forfeiture of their insurance benefits:

> If public policy dictates that those injured should be compensated it should not countenance an argument which precludes just compensation in those cases where the injurious consequences of the accident may be long in unfolding.

Hanover Ins. Co. v. Carroll, 50 Cal. Rptr. 704, 712 (Ct. App. 1966).

The many States that follow some variation of the notice-prejudice rule do so "to protect the interests of policyholders because insurance contracts are contracts of adhesion and policyholders should not lose the benefits of coverage unless the delay has prejudiced the insurance company." *Pfizer, Inc. v. Employers Ins. Co. of Wasau*, 712 A.2d 634, 644 (N.J. 1998).[7] These States, like California, override notice-forfeiture provisions that would otherwise be treated as conditions precedent:

> [A]lthough the policy may speak of the notice provision in terms of 'condition precedent,' . . . nonetheless what is involved is a forfeiture, for the carrier seeks, on account of a breach of that provision, to deny the insured the very thing paid for . . . Thus viewed, it becomes unreasonable to read the provision

[7] *See also* Richard L. Suter, *Insurer Prejudice: Analysis of an Expanding Doctrine in Insurance Coverage Law*, 46 Me. L. Rev. 221, 225-28 (1994) (discussing evolution of notice-prejudice as a rule of insurance law in Maine).

> unrealistically or to find that the carrier may forfeit the coverage, even though there is no likelihood that it was prejudiced by the breach. To do so would be unfair to insureds. It would also disserve the public interest, for insurance is an instrument of social policy that the victims of negligence be compensated.

Cooper v. Government Employees Ins. Co., 237 A.2d 870, 873-74 (N.J. 1968).

By contrast, a minority of States have declined to adopt notice-prejudice rules, and instead choose to exercise their authority to regulate the insurer-insured relationship by strictly enforcing notice provisions in insurance contracts.[8] For example, Colorado law provides that "an unexcused delay in giving notice or forwarding suit papers relieves the insurer of its obligations under the policy." *Marez v. Dairyland Ins. Co.*, 638 P.2d 286, 290 (Colo. 1981). *See also Unigard Security Ins. Co. v. North River Ins. Co.*, 594 N.E.2d 571, 573 (N.Y. 1992). But even those States that do enforce such requirements have done so because of policy concerns related to insurance. *See id.*

The similarities between the notice-prejudice rule and the mandated benefits law saved from preemption in *Metropolitan Life* also support the conclusion that the notice-prejudice rule regulates insurance and is saved from preemption. The Court in *Metropolitan Life* concluded that a "common-sense view of the matter" demonstrated that the Massachusetts law mandating mental health benefits for inclusion in ERISA plans "regulates the terms of certain insurance contracts" because it required insurers to provide a certain kind of benefit. 471 U.S. at 740. This reasoning applies with equal force here. Like the mandated benefits law, the notice-prejudice rule regulates the terms of insurance contracts by effectively imposing a

[8] Alabama, Arkansas, Colorado, the District of Columbia, Idaho, Illinois, Louisiana, Mississippi, Nevada, New York, South Dakota, Tennessee, and Virginia permit forfeiture for noncompliance with notice conditions. *See* Anderson, 65 Fordham L. Rev. at 862-68 (collecting cases).

mandatory term on all contracts by preventing insurers from strictly enforcing notice clauses in insurance policies. Accordingly, the notice-prejudice rule meets the "common-sense" test this Court has devised for determining whether a state law regulates insurance.

The notice-prejudice rule is readily distinguishable from the state law that was preempted in *Pilot Life*. There, this Court held that the saving clause did not apply, and held preempted a state common law cause of action against an insurer because "[a]ny breach of contract, and not merely breach of an insurance contract, may lead to liability for punitive damages under Mississippi law." 481 U.S. at 50. Here, by contrast, breach of a notice provision in any contract will not trigger the notice-prejudice rule because the rule only applies to contracts for insurance. The notice-prejudice rule was specifically developed in the insurance context, and courts have recognized that the rule is specifically intended for application to insurance contracts. *See, e.g., Pacific Employers Ins. Co. v. Superior Court,* 270 Cal. Rptr. 779, 783 (Ct. App. 1990) ("California's 'notice-prejudice' . . . rule was developed in the context of 'occurrence' policies"); *Safeco Title Ins. Co. v. Gannon,* 774 P.2d 30, 34 (Wash. Ct. App. 1989) (stating that Washington's notice-prejudice rule "applies to the notice provisions usually found in cooperation clauses, which exclude coverage if the insured fails to notify the insurer of accidents or occurrences in a timely manner").[9]

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[9] Indeed, the notice-prejudice rule is not only directed at the insurance industry, but in some States is directed at a specific kind of insurance policy. Although many States have notice-prejudice rules for "occurrence policies"—policies in which the event insured against is the actual mishap—some state courts have held that notice-prejudice rules do not apply to "claims-made" (*e.g.*, malpractice) policies because applying a notice-prejudice rule in that context would "alter the fundamental terms of the contract." Wherthey, 53 Md. L. Rev. at 953; *see also Pacific Employers Ins. Co.*, 270 Cal. Rptr. at 784 (to apply the notice-prejudice rule to a claims-made policy "would be to convert [the] claims-made policy into an occurrence policy").

Amicus Business Roundtable would distinguish common law rules from statutes and urges the Court to "be especially cautious" before treating common law rules as laws that regulate insurance under ERISA. *See* Business Roundtable Br. *Am. Cur.* 21. This distinction is untenable for three reasons.

First, the decisions of state courts fit squarely within the definition of "State law" in ERISA's preemption section, 29 U.S.C. § 1144, which provides that "[t]he term 'State law' includes all laws, decisions, rules, regulations, or other State action having the effect of law." *Id.* § 1144 (c)(1). Second, the common law decisions of state courts are one of the principal sources of the laws by which States regulate insurance. *See* Robert E. Keeton, *Basic Text on Insurance Law* § 8.1(b), at 542 (1971) ("Insurance transactions and institutions are subject to regulation, in a broad sense, not only at the hands of administrative agencies specially created for this purpose but also at the hands of legislatures and courts."). Third, it would be fundamentally illogical to preempt a common-law notice-prejudice rule while saving notice-prejudice rules set forth in statutes or regulations; all three kinds of rules have the same regulatory effect on the insurance industry.[10] State notice-prejudice rules of each kind are saved from preemption by ERISA's saving clause.

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[10] *Compare* Mass. Gen. L. ch. 175, § 112 ("An insurance company shall not deny insurance coverage to an insured because of failure of an insured to seasonably notify an insurance company of an occurrence, incident, [or] claim . . . which may give rise to liability insured against unless the insurance company has been prejudiced thereby.") *with Brakeman v. Potomac Ins. Co.*, 371 A.2d 193, 196-97 (Pa. 1977) (insured's failure to file notice of loss within the deadline set by policy does not bar coverage unless carrier can prove prejudice as a result; court is "reluctant . . . to allow an insurance company to refuse to provide that which it was paid for unless a sound reason exists for doing so").

B. The *Pireno* Factors Support The Conclusion That The Notice-Prejudice Rule Is A State Law Which Regulates Insurance

Applying the *Pireno* factors to the notice-prejudice rule reinforces the conclusion that the rule "regulates insurance." *Amici* will first address the two factors that the court of appeals found were met by the notice-prejudice rule and then discuss in more detail the first *Pireno* factor, risk-spreading, which it found was absent.

The second *Pireno* factor asks whether the business practice is "an integral part of the policy relationship between the insurer and the insured." *Pilot Life*, 481 U.S. at 48-49 (quoting *Pireno*, 458 U.S. at 129). The notice-prejudice rule is plainly an integral part of this relationship because it regulates the policy relationship between insurers and insureds by preventing insurance companies from strictly enforcing notice deadlines. *See Metropolitan Life*, 471 U.S. at 743 (holding mandated benefits law is an integral part of the insurer-policyholder relationship because it "limit[s] the type of insurance an insurer may sell to the policyholder"). Indeed, the regulation of the insured-insurer relationship by notice-prejudice rules is fully consistent with ERISA's fundamental objective of protecting plan beneficiaries.

UNUM contends, however, that the notice-prejudice rule is not integral to the insurer-insured relationship as required by *Pireno* because the rule "has its trunk and roots in two common-law contract rules of the broadest general application which apply to *all* private parties, including insurance companies." Pet. Br. 27. In support of this assertion, it cites general contract cases and rules related to the materiality of breaches and concludes that these cases also require that prejudice be shown before a party may be excused from performance of a contract. *Id.* at 28.

While it may be true that a finding of prejudice may be required in other contexts before a breach of contract will excuse performance, there is no general principle to

be found that, as a matter of law, notice provisions are unenforceable in the absence of a showing of prejudice. If anything, just the opposite is true. As the many States that have adopted the notice-prejudice rule have recognized, the notice-prejudice rule is a departure from traditional contract principles. Absent the existence of a notice-prejudice rule, traditional contract principles would dictate that notice provisions in insurance contracts be strictly enforced as conditions precedent to performance. *See, e.g., Marez*, 638 P.2d at 290 (strict enforcement of notice provisions is "based on traditional principles of contract law"); *Brakeman*, 371 A.2d at 196 (adopting a notice-prejudice rule because "[a] strict contractual approach is . . . inappropriate"); *Jones v. Bituminous Casualty Corp.*, 821 S.W.2d 798, 801 (Ky. 1991) (adopting notice-prejudice rule and noting that "traditional" view is that the "liability insurer need not show that it was prejudiced by an insured's unreasonable and unexcused omission or delay in giving notice") (citation and internal quotation marks omitted). Commentators also share the view that notice-prejudice rules represent a departure from traditional contract principles. *See, e.g.*, Ostrager & Newman, § 4.02[c][1], at 108-09 (collecting cases adhering to "the traditional approach [which] treats proper notice as a condition precedent to coverage").

This settled view of the notice-prejudice rule as a departure from general contract principles makes sense because, again, this rule applies only in the insurance context. *Amici* cannot find—and UNUM does not cite—a single California case that applies the notice-prejudice rule outside the insurance context. The United States' survey of California law yielded the same result. *See* Br. *Am. Cur.* U.S. 12.

UNUM also contends that the notice-prejudice rule does not satisfy the third *Pireno* factor, which asks whether the law is "limited to entities within the insurance industry." *Pilot Life*, 481 U.S. at 48 (quoting *Pireno*, 458 U.S. at 129). In its view, the notice-prejudice rule is merely " 'identified' with insurance cases." Pet. Br. 30. To sup-

port this assertion, UNUM again relies on its flawed contention that the notice-prejudice rule is a general contract principle. *See id.* And again, the answer to this assertion is that the notice-prejudice rule is identified with and applied exclusively to insurance contracts. This rule, like the mandated benefits law in *Metropolitan Life*, "impose[s] requirements only on insurers." *Metropolitan Life*, 471 U.S. at 743, and accordingly satisfies the third *Pireno* factor.

If this Court agrees with the court of appeals that the notice-prejudice rule clearly satisfies at least two of the three *Pireno* factors, it may conclude that satisfaction of the risk-spreading factor is irrelevant. There is nothing in any of this Court's prior holdings that makes a finding that all three factors are present essential before state law may be saved because it regulates insurance. UNUM, however, insists that the risk-spreading factor is indispensable to an insurance regulation, and turns for support to this Court's decisions construing the second clause of § 2(b) of the McCarran-Ferguson Act, the antitrust immunity clause. *See* Pet. Br. 24 (quoting *Royal Drug*, 440 U.S. at 211-13).

The flaw in UNUM's analysis is that *Royal Drug* did not concern saving state laws, but rather whether business practices between an insurance company and third parties constituted the "business of insurance." *See Royal Drug*, 440 U.S. at 209-10. In *Royal Drug*, this Court held that arrangements for the purchase of goods and services between an insurer and pharmacies did not constitute the "business of insurance" under McCarran-Ferguson's antitrust immunity clause. *See id.* at 217. But *Royal Drug*'s analysis of the indispensable characteristics of the "business of insurance" in the antitrust immunity context does not control the entirely distinct question of whether a state law must regulate the spread of risk in order to qualify as a law regulating insurance under ERISA.

In any event, it is also questionable whether the Ninth Circuit correctly concluded that this factor—that the

practice "has the effect of transferring or spreading a policyholder's risk," *Pilot Life*, 481 U.S. at 48 (quoting *Pireno*, 458 U.S. at 129)—is not met by the notice-prejudice rule. The notice-prejudice rule dictates that individuals should not lose coverage simply because they submit late notices to the insurer. Accordingly, the various risks that insurers guard against by including notice requirements in their policies must be addressed in other ways, possibly including higher insurance premiums to cover the additional costs that the notice-prejudice rule imposes on the insurers. This analysis is fully consistent with the Court's determination in *Metropolitan Life* that the mandated benefits law spread risk because "it was intended to effectuate the legislative judgment that the risk of mental-health care should be shared." *Metropolitan Life*, 471 U.S. at 743. Like ERISA plans in Massachusetts, insurance companies doing business in California and all other States will factor into their premiums the cost of complying with state insurance laws. Hence, *Pireno*'s risk-spreading requirement is satisfied: the notice-prejudice rule spreads risk because it alters the contractual apportionment of risk among the parties.

C. The Notice-Prejudice Rule Does Not Conflict With Any Of ERISA's Substantive Provisions, Including ERISA's Civil Enforcement Scheme

UNUM argues that the notice-prejudice rule is inconsistent with ERISA and its objectives because the rule conflicts with one or more of ERISA's statutory provisions, including its civil enforcement scheme. Pet. Br. 32-36. Properly analyzed in light of the saving clause, and Congress's clear intent to preserve the States' power to regulate insurance, these claims do not withstand analysis.

UNUM cites several provisions of ERISA, such as its fiduciary standards that require fiduciaries to follow the written terms of the plan and to pay benefits according to those terms, in an effort to demonstrate that the notice-prejudice rule would undermine ERISA's objectives. *See*

Pet. Br. 32-36. UNUM's analysis "reads the saving clause out of ERISA entirely." *Metropolitan Life*, 471 U.S. at 741. Under its reasoning, no state or federal law would be saved if it conflicted with the terms of an insurance contract. UNUM's argument turns on its head ERISA's overriding goal of protecting plan participants and their beneficiaries. *See, e.g.*, 29 U.S.C. § 1001(a). The ERISA fiduciary provisions cannot reasonably be read to require that plan terms must be enforced notwithstanding contrary state insurance law that is saved from preemption under ERISA. In other words, illegal contract terms cannot be enforced.

UNUM's other conflicts arguments are equally unavailing. UNUM argues that ERISA authorizes actions for benefits only if they are "due," while the notice-prejudice rule requires payment even if benefits are not due under the contract. Pet. Br. 35. This analysis is flawed because if the notice-prejudice rule is saved, then benefits are due under § 502(a)(1)(B), 29 U.S.C. § 1132(a)(1)(B), despite contractual terms to the contrary. After all, it is unquestionable that only the *enforceable* terms of contracts determine whether beneficiaries are entitled to benefits.

Furthermore, UNUM's claim that the notice-prejudice rule "conflicts with . . . the orderly internal resolution of benefits disputes as a prerequisite to filing suit," Pet. Br. 34, is merely a restatement of its claim that under ERISA it is entitled to literal enforcement of the contract and that state law may not regulate the enforceability of those terms. Again UNUM's contention proves too much because if it is correct, the saving clause would be read out of ERISA completely.

UNUM's argument that the notice-prejudice rule conflicts with ERISA's civil enforcement scheme is also untenable. In *Pilot Life*—a case UNUM argues is controlling here—the plaintiff sued an insurer in a diversity case under a state cause of action that was not covered by the saving clause and that conflicted with ERISA's

civil enforcement scheme. *See* 481 U.S. at 43-44, 57. Here, respondent's suit was brought under federal question jurisdiction in federal court seeking relief only under ERISA § 502(a)(1)(B), 29 U.S.C. § 1132(a)(1)(B). *See* Pet. App. 77a. The notice-prejudice rule does not itself create a cause of action for Mr. Ward; it merely provides a basis under which the notice provision in the contract may not be read to prevent recovery of benefits that would otherwise be due under the terms of the plan. The notice-prejudice rule is therefore properly viewed as a state insurance law that is applied in conjunction with—not in opposition to—ERISA's civil enforcement scheme.

Finally, UNUM predicts a doomsday scenario of "a multiplicity of conflicting federal-state laws on ERISA plan administration" if this Court allows the Ninth Circuit's decision to stand. Pet. Br. 31. Yet UNUM offers no evidence of serious complications stemming from state application of the notice-prejudice rule. If it were correct about the impending dire effects of these rules on ERISA plan management, the consequences would surely have been manifested in at least some of the dozens of States with notice-prejudice rules.

The insurance industry made similar doomsday arguments 15 years ago in *Metropolitan Life*. *See* Brief for Appellant, *Metropolitan Life*, 471 U.S. 724 (1985) (No. 84-325) (arguing that failure to preempt Massachusetts mandated benefits law would "severely hamper the efforts of multistate employers to maintain uniform ERISA plans"). The Court properly rejected this line of argument in that case, and should do so here as well. While UNUM's argument "would eliminate some of the disuniformities currently facing national plans that enter into local markets to purchase insurance[, s]uch disuniformities . . . are the inevitable result of the congressional decision to 'save' local insurance regulation." *Metropolitan Life*, 471 U.S. at 747.

III. THE *ELFSTROM* RULE IS SAVED FROM PREEMPTION

In *Elfstrom v. New York Life Ins. Co.*, 432 P.2d 731 (Cal. 1967), the California Supreme Court announced the rule of insurance law "that the employer is the agent of the insurer in performing the duties of administering group insurance policies." *Id.* at 737. The court of appeals held that the *Elfstrom* rule is not subject to ERISA preemption under § 514(a) because the rule does not "relate to" an employee benefit plan. Pet. App. 20a-24a. Accordingly, the court of appeals had no occasion to address the question whether the *Elfstrom* rule is saved as a rule regulating insurance under § 514(b). If this Court concludes that the *Elfstrom* rule "relate[s] to" ERISA plans under § 514(a), *amici* submit that the *Elfstrom* rule meets the common-sense test for a state law that regulates insurance, satisfies the *Pireno* factors, and does not conflict with ERISA. It is therefore saved from preemption.

A. The *Elfstrom* Rule Meets The Common-Sense Definition Of A Law That Regulates Insurance

The *Elfstrom* rule, which predates ERISA by seven years, was adopted by the California Supreme Court to govern "whether an employer acts as the agent of the insurer or of the employees in administering a policy of group insurance." 432 P.2d at 736. Rejecting the traditional rule making the employer the agent of the employees, the California court joined the courts of several other States in holding that the mistakes of an employer, when acting on behalf of the insurance company, will be imputed to the insurer because the employer is the agent of the insurance company when it administers group plans. *See id.* at 737.

Not all courts have followed the *Elfstrom* approach. *See id.* at 736. The traditional agency rule places the burden of employer mistakes upon the insured, and thus binds

the employees by actions of the employer.[11] This Court, distilling state law, articulated this rule in *Boseman v. Connecticut General Life Ins. Co.*:

> When procuring the policy, obtaining applications of employees, taking pay roll deduction orders, reporting changes in the insured group, paying premiums, and, generally, in doing whatever may serve to obtain and keep the insurance in force, employers act not as agents of the insurer, but for their employees or for themselves.

301 U.S. 196, 204 (1937) (citing cases from six states). The *Elfstrom* rule, by contrast, rejects this approach and places the cost of employer mistakes when administering a plan upon the insurer.[12]

The *Elfstrom* rule is just one part of an insurance regulatory scheme created to protect persons insured under group policies. As Judge Mosk explained in *Elfstrom*, the rule protects beneficiaries from the inequitable outcome of losing benefits due to the mistakes of employers: "[T]he employer carries out the functions which the insurer necessarily would perform in other types of insurance and thereby confers a substantial benefit on the insurer, and . . . since the individual employee has no knowledge of or control over the administrative acts performed by the employer, it would be inequitable to charge him with the employer's errors." 432 P.2d at 737. *See also Norby v. Bankers Life Co.*, 231 N.W.2d 665, 668-69 (Minn. 1975) ("[p]ragmatic, as well as theoretical, considerations" establish that the "conventional" rule is "unreasonable and

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[11] *See* Lee R. Russ & Thomas F. Segalla, *Couch on Insurance* § 8:10 nn. 89-99 and accompanying text (3d ed. 1997) (citing state court decisions rejecting traditional rule); J.A. Appleman & J. Appleman, *Insurance Law and Practice* § 43 (1995 & 1998 Supp.) (citing state cases that make the employer an agent for the insured).

[12] *See Elfstrom*, 432 P.2d at 736-37 (citing six state cases); *Couch On Insurance* § 8:11-8:13 (collecting cases); J.A. Appleman & J. Appleman § 43 (collecting cases).

inequitable"); *Neider v. Continental Assurance Co.*, 35 So.2d 237, 240 (La. 1948) (deeming the employer the agent of the insurer in order to give group insurance "every legitimate opportunity of becoming a social agency of real consequence"). *Cf. Northwestern Nat. Life Ins. Co. v. Riggs*, 203 U.S. 243, 254 (1906) (noting protective purposes of state regulation of life insurance).

The *Elfstrom* rule—"that the employer is the agent of the insurer in performing the duties of administering group insurance policies," 432 P.2d at 737—expressly resolves the designation of agency relationships within the context of group insurance contracts. *See Metropolitan Life Ins. Co. v. State Bd. of Equalization*, 652 P.2d 426, 431 (Cal. 1982) ("*Elfstrom* . . . is controlling on the question of agency. . . . We held as a matter of law that 'the employer is the agent of the insurer in performing the duties of administering group insurance policies.'") (quoting 432 P.2d at 737). Because *Elfstrom* was clearly motivated by a concern unique to group insurance and, like ERISA, directed at protecting beneficiaries, this rule of law is well within this Court's common-sense test for the state laws that Congress intended to save under ERISA.

In 1968, the year after *Elfstrom* was decided, the California legislature enacted a statutory provision that gives parties to group life insurance contracts the ability to modify the *Elfstrom* rule by agreement. California Insurance Code § 10209, found in the Group Life Policies section of the Code, provides that "[t]he contract of insurance and individual certificate may contain provisions defining the extent to which the employer acts as the agent of the employee or may act as the agent of the insurer." The enactment of § 10209 demonstrates that the legislature has addressed the agency question in the group life insurance context and authorized parties to depart from the rule. The existence of § 10209, expressly providing for departures from *Elfstrom* in group life insurance contracts but leaving that rule in place for other

group insurance contracts, reinforces the conclusion that *Elfstrom* is a state law that regulates insurance. *See Elfstrom*, 432 P.2d at 738 n.9 (noting the lack of legislation concerning the agency relationship in group policies as justification for creation of a common-law rule).[13]

California's scheme regulating agency relationships in group insurance contracts is specifically directed at the insurance industry. Therefore, the entirety of the law—part common law and part statutory—is saved under ERISA because together it comprises the state law that determines agency relationships in group insurance.

B. The *Pireno* Factors Support The Conclusion That The *Elfstrom* Rule Is A Law Regulating Insurance

The *Pireno* factors also support the conclusion that the *Elfstrom* rule is a state law that regulates insurance. The first *Pireno* factor, "risk-spreading," presents the closest question, although *Elfstrom* satisfies that factor as well as the other two. As explained above, *see* pp. 5-10, *supra*, a state law need not satisfy all three *Pireno* factors in order to be saved. In any event, the *Elfstrom* rule satisfies all three, including the risk-spreading factor. The rule is similar to the Ohio statute saved in *Fabe*, which protected the insured by ensuring performance of the insurance contract in the event of the company's intervening bankruptcy. *See* 508 U.S. at 503-04. This Court held the statute satisfied the risk-spreading factor of *Pireno* because "actual performance of an insurance contract falls within the 'business of insurance,'" and "[w]ithout performance of the terms of the insurance policy, there is no

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[13] The court of appeals suggested that an insurer's "overt disavowal of the sufficiency of the employer's performance of functions under the plan, actually communicated" to the insured might foreclose reliance on the relationships created as a matter of law by *Elfstrom*. Pet. App. 23a. The court of appeals also highlighted *Elfstrom's* status as a special rule of law by recognizing that under common law principles of agency, the facts, and not the understanding of the parties, define the agency relationship. *Id.* at 14a-15a.

risk transfer at all." *Id.* *Elfstrom* likewise affects the transfer of risk by requiring performance of the insurance contract despite the occurrence of events that might otherwise relieve the insurer of that responsibility.

The second and third *Pireno* factors are also satisfied because, by treating the employer as the agent of the insurer, the *Elfstrom* rule dictates the terms of the insurance relationship, thus becoming " 'an integral part of the policy relationship between the insurer and the insured.' " *Metropolitan Life*, 471 U.S. at 743 (quoting 458 U.S. at 129). The third *Pireno* factor looks to whether a law " 'is limited to entities within the insurance industry.' " [14] *Metropolitan Life*, 471 U.S. at 743 (quoting 458 U.S. at 129). The *Elfstrom* rule and § 10209 of the California Insurance Code apply and, by their express terms, relate exclusively to the relationship between employers and insurers with the required "intent of affecting the relationship between the insurer and the policyholder." *Metropolitan Life*, 471 U.S. at 743. Thus, application of *Pireno* supports the common-sense conclusion that California's group insurance agency rule is saved.

C. The *Elfstrom* Rule Is Consistent With ERISA's Fiduciary Provisions

The *Elfstrom* rule cannot be saved if it is inconsistent with "the role of the saving clause in ERISA as a whole." *See Pilot Life*, 481 U.S. at 51. In this regard, UNUM argues that the *Elfstrom* rule "directly conflicts with [ERISA's] specific fiduciary and co-fiduciary responsibility rules." [15] Pet. Br. 43. Similarly, the United States

[14] Some state courts even draw upon the authority of state statutes defining insurance agents to liken the employer to an ordinary insurance agent when performing administrative tasks. *See, e.g., Cason v. Aetna Life Ins. Co.*, 85 S.E.2d 568, 573 (Ga. Ct. App. 1954) (citing Georgia's statute defining "insurance agents," formerly § 56-501, now § 33-23-1).

[15] In order to further buttress its argument that the *Elfstrom* rule is in conflict with ERISA, UNUM argues that *Elfstrom* conflicts with the civil enforcement provisions of ERISA. Pet. Br. 45.

asserts, without explanation, that the *Elfstrom* rule "forces the employer, as plan administrator, to assume a role, with attendant legal duties and consequences, that it has not undertaken voluntarily." Br. *Am. Cur.* U.S. 27. These contentions are erroneous. The *Elfstrom* rule creates no duties or obligations. Rather, as the court of appeals noted, *see* Pet. App. 22a, it describes the legal consequences of administrative duties undertaken voluntarily by employers.

Furthermore, ERISA's fiduciary provisions do not conflict with *Elfstrom*. An employer has a fiduciary duty only "to the extent" of particular discretionary fiduciary functions that he or she elects to perform, 29 U.S.C. § 1002(21)(A), and the hallmark of all fiduciary functions is discretion. Fiduciary functions include asset management, discretionary administrative functions and investment advice. Whether a fiduciary is "named" under § 402(a), 29 U.S.C. § 1102(a), or is considered one under 29 U.S.C. § 1002(21)(a), ERISA creates obligations for the employer only when an employer acts as a fiduciary, *i.e.* when exercising discretionary authority or control over plan management. *See* 29 C.F.R. § 2509.75-8. Thus, when an insured alleges a breach of fiduciary duty,[16] the court must begin by asking "whether a person is a fiduciary with respect to the particular activity at issue," for a fiduciary for some purposes is not a fiduciary for all

Like the notice-prejudice rule, however, the *Elfstrom* rule does not create a remedy. Instead, it works within the enforcement scheme created by Congress.

[16] A fiduciary owes several duties to the beneficiaries. First, the fiduciary must act "solely in the interest of the participants and beneficiaries." 29 U.S.C. § 1104(a)(1). Ordinarily, a breach of this duty involves a material misrepresentation to beneficiaries. Second, the fiduciary must act with "prudence," *id.* § 1104(a)(1)(B), which has been applied almost exclusively to the management of funds. Third, the fiduciary has an obligation of "diversifying the investments" for the benefit of the plan. *Id.* § 1104(a)(1)(C). Finally, a fiduciary must act in accordance with the plan. *Id.* § 1104(a)(1)(D).

purposes. *Coleman v. Nationwide Life Ins. Co.*, 969 F.2d 54, 61 (4th Cir. 1992), *cert. denied*, 506 U.S. 1081 (1993).

The types of actions that create an agency relationship, such as exists under *Elfstrom*, are not parallel to fiduciary obligations. Factors that traditionally create an employer-insurer agency relationship include determining eligibility, forwarding premiums and reinstating employees. *See Couch on Insurance* § 8:11. These are not actions that would create a fiduciary duty because they are ministerial and administrative, not discretionary. *See* Interpretive Bulletins Relating to ERISA, 29 C.F.R. § 2509.75-8 (DOL statement that "a person who performs purely ministerial functions such as [collection of contributions] for an employee benefit plan within a framework of policies, interpretations, rules, practices and procedures made by other persons is not a fiduciary because such person does not have discretionary authority"). Furthermore, the *Elfstrom* analysis, like fiduciary analysis, is restricted to the activities actually undertaken by the employer to determine an agency relationship. *See, e.g., Baum v. Massachusetts Mutual Life Ins. Co.*, 357 P.2d 960, 964 (Okla. 1960) ("In performing these functions employer acted as the agent of insurer, and since it so acted, insurer is charged with knowledge possessed by employer while so acting.").

Moreover, the insurer, concerned that *Elfstrom* might be implicated by the actions of an employer fiduciary, may take steps to avoid the consequences imposed by *Elfstrom*. Section 10209 of the California Insurance Code potentially gives the insurer the ability to define the agency relationship in at least some plans although, as the court of appeals recognized, a "hidden disclaimer" alone cannot negate the agency relationship because "the participants . . . should be able to rely upon the relationships that exist." Pet. App. 23a.

Finally, ERISA is silent with respect to the insurance agency relationship. "A reading of [the preemption

clause] resulting in the pre-emption of traditionally state-regulated substantive law in those areas where ERISA has nothing to say would be 'unsettling.' " *California Div. of Labor Standards Enforcement v. Dillingham Constr., N.A.*, 519 U.S. 316, 330 (1997) (quoting *Travelers*, 514 U.S. at 665). ERISA does not address which individuals may be designated an agent of the group insurer; a state law with respect to such an issue is plainly consistent with ERISA's objective of protecting beneficiaries. The United States appears to agree that the *Elfstrom* rule would not conflict with the fiduciary provisions of ERISA because it suggests that this rule could be adopted as a matter of federal common law. *See* Br. *Am. Cur.* U.S. 28. However, the determination of whether and when an employer is the agent of a group insurer is best left to state law, as it is an issue that falls squarely within the regulation of insurance, a responsibility of the States for 150 years.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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January 8, 1999